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ABSTRACT

Sustainable growth has economic policies addressed to current imbalances as its necessary, though not its sufficient, condition. Labor markets are important for the growth process; as the level of economic activity increases, they function better, and as they function better, the level of economic activity increases further. Labor market flexibility is a key to both economic efficiency and social progress. Considerations of differences between countries has led to the conclusion that so far as labor market flexibility is concerned, no one package of measures exists that can serve all countries equally well. Six categories of factors affect the flexibility of labor markets: labor costs, conditions of employment, work practices and work patterns, rules and regulations, mobility, and education and training. Within each category are issues that provide levers for change. These issues are also related to the four widely recognized needs in Organisation for Economic Co-operation and Development countries, needs that call for greater flexibility, including labor market flexibility: economic adjustment, technological innovation, social problems, and quality of life. (YLB)

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# Labour Market Flexibility

Report by a high-level group of experts to the Secretary-General

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- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

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## PREFACE

The prevailing high levels of unemployment and the clear need for structural adjustment have led to a questioning of the way in which labour markets presently operate. Perfection is, no doubt, unattainable in any market but evidence has seemed to be building up that there are undesirable rigidities in labour markets, the easing of which could produce beneficial effects both for economic growth and for the creation of jobs.

With this in mind I decided to establish, on the advice of the OECD Manpower and Social Affairs Committee, a High-Level Expert Group to examine the working of labour markets and to advise me on relevant policy options for increased flexibility, in the fields of both government policy and collective bargaining. I entrusted the leadership of this work to Professor Ralf Dahrendorf, of the University of Konstanz, a man of exceptionally wide and rich experience. The members chosen for the Group were people with distinguished experience in industry, in the world of labour, or in the public service. They served in their capacity as individuals so that their Report does not commit OECD governments.

Professor Dahrendorf and his colleagues have worked diligently and speedily. Their Report is in my opinion a valuable and well-balanced document. It is also a unanimously agreed Report – a point of some importance given the substantial presence of members with a background in business, labour and government, and bearing in mind that labour market flexibility is a controversial issue in many countries. The Report rightly points out that greater flexibility in the labour market is no panacea, but that it is nevertheless a means for quite substantial amelioration of current economic and social problems. But it also points out that many so-called "rigidities" in the labour market represent valued protection for the people concerned. It is clear that in considering policy options weight should be given to social and human as well as economic factors. There is no necessary contradiction between flexibility and security. Indeed, reducing uncertainty can contribute usefully to improving flexibility.

I have already brought the Report to the attention of OECD Member governments and it will be a valuable input to our continuing work on employment and on structural adjustment. We shall also discuss it with representatives of our Business and Industry Advisory Committee and our Trade Union Advisory Committee – who are not, of course, in any way committed by its findings. But I have also decided on speedy publication of this Report, because I believe that its analysis and proposals will be found important by policy-makers, as much in business circles and amongst trade unions as in government. I hope also that it will be widely read by the general public.

Jean-Claude Paye
Secretary-General of the OECD



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1. In October 1985, the Secretary General of the OECD set up a High-Level Group of Experts on Labour Market Flexibility, and asked it "to report on relevant policy options, in the field of government policies and collective bargaining, with a view to enhancing both economic efficiency and social progress in the OECD countries".

Members of the Group were*:

Ralf DAHRENDORF (Chairman)
Martine AUBRY
Douglas FRASER
Joseph ISAAC
Lennart JOHANSSON
Yotaro KOBAYASHI
Harold O'SULLIVAN

The Group has held three meetings, on 21-23 November 1985, 9-11 January and 2-3 April 1986. It has had a preliminary and informal exchange of views with representatives of employers' organisations (BIAC) and trade unions (TUAC). The Group has been able to draw on the services of the OECD, and has done so generously. A technical analysis prepared by the Secretariat on labour market flexibility has informed the work of the Group throughout. Mr. R.O. Clarke has served as Secretary to the Group.

2. While the Group is described as one of experts, its expertise is not primarily technical. We have therefore not tried to emulate, supplement or amend the technical report by the Secretariat. Instead, the Group has applied the experience of its members in practical affairs to the large body of data and analysis put before it. We have seen our task as one of translating available knowledge on labour market flexibility into a form that is helpful for decision-making. This has involved the selection of issues of particular importance, and an assessment of the relative weight of issues and packages for action. Both selection and assessment are matters of judgement. Given the varieties of professional experience and cultural background represented within the Group, it would be surprising if we had agreed in our judgements in all respects. However, the Report as it stands has our unanimous approval.

It reflects our common view about economic efficiency not being an end in itself, but having to serve individual welfare, and that social progress cannot be achieved without a high level of economic activity. Just societies have to be built on healthy economies.

* Ralf Dahrendorf is Professor of Social Science, University of Konstanz, Germany, and a former member of the Commission of the European Communities. Martine Aubry is Director of Labour-Management Relations in the French Ministry of Labour. Douglas Fraser is Professor of Labor Studies, Wayne State University, and a former President of the United Automobile Workers of America. Joseph Isaac is Deputy President of the Australian Conciliation and Arbitration Commission. Lennart Johansson is Chairman of AB SKF, and President of the Federation of Swedish Industries. Yotaro Kobayashi is President of Fuji Xerox Co. Ltd., Japan. Harold O'Sullivan is Executive Chairman of the Health Services Development Corporation, and a former General Secretary of the Local Government and Public Services Union, Ireland. Members of the Group served in their personal capacity and the views expressed do not commit any organisation with which they are connected.

3. Labour market flexibility is a part of this process. As we see it, flexibility refers to the ability of individuals in the economy, and notably in the labour market, to abandon established ways and adapt to new circumstances. This is partly a matter of personal capacity, and partly one of given conditions. Personal capacity in turn relates to the talents and qualifications of people as well as to their willingness; given conditions may be economic, social or political. It can readily be seen that flexibility, thus understood, is part of a wider social and economic capacity for change, involving institutions as well as individuals, employers as well as workers.

4. Whether people are naturally flexible, and whether flexibility is desirable as such, may be debatable propositions. On occasion there are likely to be conflicts between inter-related needs and the wish to change and the wish to hold on to what one has got, flexibility and security, and we shall point to some of these conflicts. But in the OECD countries today, there are at least four widely recognised needs which call for greater flexibility, including labour market flexibility:

- The need for *economic adjustment*. The "shocks" of the 1970s (energy, inflation, interest rates, and changing patterns of international trade) have underlined the importance of greater responsiveness in labour markets, as well as product and factor markets, to minimise the effects of such shocks on economic growth and to promote a more competitive and efficient economic environment.
- The need for *technological innovation*. New inventions and new forms of human organisation ("information society") have combined to open up economic and social opportunities.
- The need to deal with new *social problems*. Persistent unemployment has become the dominant social issue in many OECD countries; it is often accompanied by other social problems (inner-city squalor, crime) which require responses.
- The need to enhance the *quality of life*. Changing expectations and aspirations of people as employees, but also in their lives beyond the world of employment, create demands for action.

5. The need to fight unemployment is clearly a major motive for OECD concerns with labour market flexibility. However, we found that we could not confine ourselves to this motive, nor did we wish to do so. The needs which we take as our point of departure are related in intricate ways; in practical terms there are trade-offs, say, between the labour market implications of technological change and opportunities for a higher quality of life. Such trade-offs need to be emphasized if one seeks to achieve a balance between economic efficiency and social progress.

## ECONOMIC GROWTH AND STRUCTURAL CHANGE

6. Labour market flexibility is not a panacea for all social and economic ills. It is but one – and not the most important – factor affecting economic and social progress and has to be seen in the context of general economic and social trends. After an unprecedented quarter-century of economic expansion, the 1970s brought great uncertainties. These have affected all major objectives of economic policy. OECD countries have come to grips with

them gradually, though unevenly and incompletely. By the mid-1980s, two features characterise the economic scene. There has been a period of favourable economic developments in many OECD countries, notably with respect to growth and the control of inflation. At the same time, there continue to be what the Secretary General has called, "dark clouds marring the picture: inequalities of performance across countries, levels of unemployment in a number of countries not seen for half a century, massive balance-of-payments disequilibria, unstable exchange rates, the vulnerability of the developing countries"[1].

7. It is relevant to note that labour markets reflect these general trends. Until about 1973, they can be said to have operated more or less smoothly. Since then, a more chequered, and on the whole problematic picture has emerged. Increases in unemployment were not linear, and there are wide variations between countries, but in the OECD area as a whole unemployment has trebled since the early 1970s. In some OECD countries, such as the United States, new jobs have been created at the rate of 2 per cent per annum; in others, employment has remained steady, or has even shrunk. In Japan, technological change has been accompanied by massive programmes of re-training within enterprises; elsewhere, the number of unskilled at the margin of the labour market has grown. Labour markets in OECD countries are not functioning as well as they might, either in terms of economic or of social objectives.

8. If one adopts a medium-term perspective, and looks to the early 1990s, the objectives are fairly clear. They could be expressed in terms of the classical goals of economic policy, or of the needs spelt out above (in paragraph 4). Either way, one is seeking efficient economies which are technologically innovative, while current social problems have been ameliorated and the quality of people's lives has been improved. More modestly, the OECD countries might aim at a substantial reduction of Europe's present high rate of unemployment, reining it back to, say, the 1979 level of around 5½ per cent, and bringing about more evenly distributed current balance positions which at the same time offer reasonable possibilities of proving sustainable. In addition, there is a need to consolidate recent gains in the fight against inflation which, for OECD countries as a whole, has brought it below 5 per cent, and for setting reasonable targets for public sector borrowing, debt to GNP ratios, and interest payments on public debt.

9. The economic policy options available in order to achieve these medium-term objectives are not greatly in dispute, though particular policies are, and the options vary from country to country. Non-inflationary growth is at the heart of these policies. This can be achieved only if a concerted international effort is made to deal with major imbalances of the current system. Current account deficits, public sector deficits, exchange rate volatility, trade disequilibria, external debt, all present problems which have to be resolved, if sustainable and significant growth is the objective.

10. However, it is now widely accepted that traditional conjunctural measures of macro-economic policy will not suffice to bring about the growth dynamic which is needed in order to attain the medium-term goals. These measures are undoubtedly important, indeed critical; they justly command the attention of analysts and policy-makers alike; but unless structural change is added to them, their effect is likely to fall short of needs and aspirations. "Structural" in this context calls for changes of attitudes and institutions which are a prerequisite of sustainable growth without being a necessary part of traditional economic policy. The often-cited spirit of enterprise belongs in this category, as does adequate spending on research and development. The international trade and monetary system must be open for new actors and must provide a reliable framework for all. Labour market flexibility has its place in this set of structural policies.

11. *In sum, then, sustainable growth has economic policies addressed to current imbalances as its necessary, though not its sufficient, condition. The latter has to be provided by a structural package of which labour market flexibility is one part. However, within these rather closely defined limits, the operation of labour markets is of strategic importance. Labour markets are important for the growth process itself; as the level of economic activity increases, they function better, and as they function better, the level of economic activity increases further. Such flexibility then serves not only processes of adjustment, but also innovation, equity, and a higher quality of life. It should be seen as an active agent of a manpower policy which is supportive of an overall objective of increasing the levels of employment. In this sense, labour market flexibility is a key to both economic efficiency and social progress.*

## A WORLD OF DIFFERENCES

12. There are economic problems affecting all OECD countries, and economic policy objectives which most of them share. But in considering the question of labour markets, we were forcefully reminded of the differences between countries. Variations in unemployment rates or job creation figures tell a part of the story, as do the dominant subjects of public debate in different countries. Such differences have to do with the history, culture, and institutions of countries as much as with current policies. They are not readily changed, nor is it always desirable to change them. Throughout our Report, we have considered it important to take such differences into account.

13. Perhaps it would be useful to reduce the differences between OECD countries to three or four models. However, we have not found this feasible. For one thing, there are no unambiguous patterns anywhere; every country displays a mixture of elements. For another thing, every such mixture seems unique. The following observations are therefore no more than indications of what we have in mind:

- In the United States, a tradition of geographical (and perhaps social) mobility has persisted which stems back to pioneer days, and has no equivalent in most other OECD countries.
- In Japan, the post-war condition has given rise to a practice by which large firms offer their core labour force strong employment protection while expecting it to remain internally mobile to an extent which is unknown elsewhere.
- In Germany, trade unions organised on an industrial basis, coupled with institutions of co-determination (and other historical factors) have led to moderate wage demands, whereas the absence of these factors in countries like the United Kingdom has had the reverse effect.
- In France, the role of government in industrial relations is a direct result of the relative weakness of the organisations of employees and employers; both may have deep historical roots.
- In a number of (mostly smaller) European countries, an implicit or explicit consensus between unions, employers and government has helped prevent frictions such as contributed elsewhere to the rapid rise in unemployment.

These are but illustrations. Careful analysis of the annual OECD country economic surveys would make a more systematic description possible.

14. It would be wrong to regard such differences simply as given. To some extent, structural change is bound to mean change in prevailing values and attitudes. Yet it is not only notoriously difficult to transplant institutions from one country to another, but it takes a long time to transform entrenched patterns of culture. *Consideration of differences between countries has therefore led us to the conclusion that so far as labour market flexibility is concerned, there is no one package of measures which can serve all countries equally well. The issues and packages which we have singled out as options need to be adapted to specific conditions. Moreover, this is not a reluctant conclusion; cultural uniqueness is also a source of strength. In other words, we believe that there is more than one route which leads to the goals of effective adjustment, continuous innovation, higher employment, and a better quality of life.*

## ISSUES OF MAJOR IMPORTANCE

15. Numerous factors affect the flexibility of labour markets. For the purposes of this Report, we have found it useful to group them into six categories:

- *Labour costs*, including the general level of wages, wage differentials, and non-wage labour costs.
- *Conditions of employment*, including employment protection, and types of labour contract.
- *Work practices and work patterns*, including arrangements for working time and the environment and organisation of work.
- *Rules and regulations* relating to the labour market, including general rules, taxation, and regulations concerning small businesses.
- *Mobility*, including both external and internal mobility.
- *Education and training*.

These categories are convenient rather than systematic; there are obvious overlaps. The following discussion of issues is moreover not intended to be exhaustive. Its purpose is to identify, within the various categories, those issues which provide levers for change, and to assess their relative importance for labour market flexibility.

### Labour Costs

16. Along with employment protection, labour cost is the most frequently mentioned and, not surprisingly, the most contentious issue related to labour market flexibility. Even in technical terms the issue is both difficult and controversial. We have therefore tried to face it squarely. Historically, there can be little doubt that rapidly rising labour cost is related to the emergence of labour market imbalances, including unemployment. Even this relationship is not simple. While rises in unemployment between the two oil shocks can to a considerable

extent be accounted for by increases in labour costs, other factors, such as sluggish demand growth and high real interest rates, must be adduced to explain developments since 1980. However, the Secretariat tells us that countries where real wages were most rigid tended to experience the largest growth in unemployment and vice versa. Theoretically, total wage flexibility would "clear" labour markets within a certain period. More specifically, economic literature suggests that with unchanged output, a 1 per cent fall in real wages would result, in the long term, in an increase in employment of 0.2 to 0.5 per cent or more. But in practice, such figures are of little use, even apart from "the long run". Wages (as well as non-wage labour costs) are not only "sticky", but it is undesirable, for reasons of equity as well as demand creation, to allow major downward fluctuations of labour costs. *This leads to the conclusion that control of labour costs, and notably wage moderation, is of critical importance in the context of the objectives pursued here. Wherever real wages are allowed to grow above productivity increases, broadly speaking, additional unemployment will follow. However, such wage moderation does not mean that real wages must remain static and not rise over time.*

17. *Assuming the objectives which underly this Report, this conclusion suggests as a minimum strategy the avoidance of all mechanisms which would lead to wage increases above productivity increases, be they institutional or automatic. In addition, it can be said that unless real labour cost increases remain somewhat below productivity increases, there is little room for manœuvre for other forms of flexibility, including shorter working hours.*

18. A different set of questions is raised by wage differentials. In the first instance, the Secretariat's work suggests that these are in fact less rigid than wage levels, though there are large and significant differences between countries. Moreover, it would seem that wage differentials can act as incentives, not just in the crude sense of individual competition in the market, but in that of leading to structural changes with respect to regions, industries, skills and age groups. The question is, at what level do wage differentials provide desirable incentives; the answer will be different for different countries.

19. *It is also likely to be different for different kinds of wage differentials. Four of these are particularly important. Regional differentials are one element in the process of (external) mobility. Inter-industry differentials have been studied quite extensively. They clearly are relevant for structural change, but do not seem to require major action. There is however a problem with regard to skill differentials, especially in European countries. When methods of wage-fixing reduce them too much, a process of de-skilling is encouraged which is equally detrimental in terms of economic adjustment and technological change. So far as wage rigidity for young people is concerned, the evidence suggests that it is at least partly responsible for youth unemployment in some countries.*

20. Non-wage labour cost is used here to refer to directly employment-related expenditure on the part of employers; thus it does not include the cost of health and safety measures and other indirectly employment-related expenditure. The following statements are also confined to statutory non-wage labour cost. Even so, this is a significant factor. It is above all an ambivalent factor. On the one hand, statutory non-wage labour cost is, in many countries, an important source of finance for measures of health and social policy; on the other hand, it is a tax on labour which can deter employment. As a source of revenue for social policy, it is clearly important. The question is then, how important is it as a tax on labour? It would seem to weigh particularly heavily on labour-intensive enterprises, and notably on small businesses, but we are told that the evidence is inconclusive. *Where statutory non-wage labour costs are a significant proportion of total labour costs, or have risen sharply in recent years, we feel that on balance there is a good case for their reduction. In those countries where the present budgetary*

*policy rules out any fiscal expansion, such cuts in non-wage labour costs would have to be financed by an alternative tax and/or cuts in public expenditure. Such options should be explored with a view to encouraging enterprises to hire new labour. The recent steep fall in oil prices has created a further possible option here. In some countries domestic taxes on oil could be increased and the revenue thereby raised used to cut payroll taxes on labour.*

**Conditions of Employment**

21. The second difficult and contentious set of issues concerns conditions of employment. Wages and job security are the two most sought-after rewards of employment. Sometimes, they are traded off against each other; recent events in several parts of the OECD area (such as some widely publicised agreements in the United States, or the acceptance of limitations on wage indexing in Belgium, France and Italy) suggest that for employees the importance of job security in these trade-offs is still very high. At the same time, employment protection introduces an element of rigidity into labour markets. Job security measures impose a cost on employers. By raising average labour costs, such policies lower employment levels, inhibit speedy adjustments to changes in market conditions and, through the granting of exemptions, encourage part-time employment and growth of the unprotected sector. However, while these are theoretically predictable results, the extent to which these consequences actually occur in practice is, unfortunately, not reliably demonstrated. Of the countries which do reasonably well in employment terms, some are highly regulated (e.g. Sweden or Austria), others highly unregulated (e.g. the United States or Japan). *This then is the issue: both security and flexibility are desirable. When it comes to conditions of employment, the two are probably in conflict, though the evidence is not clear. For these reasons of value and of fact, it would be wrong to come down firmly on one side or the other. The practical question is how one can strike a balance between desirable job security and necessary labour market flexibility. The answer may well be different in different historical and institutional contexts, though a rising tide of economic development leading to increasing levels of employment would help in generating confidence that flexibility is a desirable feature of any labour market policy.*

22. This conclusion is not as vague as it may appear. When it comes to employment protection proper, it means that certain changes are indicated. As in the case of real wages, the period in which OECD economies could least afford it, that is the years following the first oil shock, was also a time in which understandable fears and wishes led to an increase in labour market rigidities. Employment protection measures were introduced in many countries which had to be corrected when it became clear that job security legislation had itself become part of the structural problem. Since 1980, the range of application and details of dismissal procedures have been changed in many countries, either by legislation or by collective bargaining. We regard it as conceivable that, in this manner, a new balance of security and flexibility is emerging, though the effect of these changes on labour markets should not be exaggerated.

23. Arguably, the spreading of new types of labour contract is at least as important as adjustments in employment protection rules. This is notably true for part-time employment. The incidence of part-time employment has increased more rapidly, in most OECD countries, in the 1980s than in the latter part of the 1970s. We regard this as a largely desirable development since it meets both the needs of the labour market and the wishes of new entrants to this market, especially women. Part-time contracts can, however, be abused. Abuses of part-time work suggest the need for a surveillance system. If part-time work is involuntary it is

but another facet of underemployment. However, in so far as the employment problem reflects a mismatch of jobs offered and work sought, the greater variety of forms of contract is desirable.

24. In recent years, there has also been a wider use of limited-term contracts of labour. So far, hard evidence is scarce; but in at least one country, Germany, legislation has made limited-term employment of up to 18 months possible without application of general dismissal procedures. In part, such contracts replace previous agreed forms of probation; in part, they enable employers to react more flexibly to market fluctuations. There is a thin line here between desirable changes and what has been called "the growth of the unprotected sector", and views differ on whether this line has been crossed already or not.

25. The underlying question concerning conditions of employment is how to strike a balance between desirable job security and necessary labour market flexibility. Ideally, one would wish to achieve this for each individual, so that people are both securely employed and able to adapt to changing circumstances. In practice this is rarely possible. *And in particular, there arises the question of the distinction between a core of securely employed people and a periphery of more mobile employees. To some extent this has always existed. It is moreover by no means always undesirable. There is no reason why conditions of work should be worse for those who are not permanently employed. It should also not be assumed that there is no movement of peripheral labour to this solid core. For many, peripheral employment may be no more than a short transition to core employment. For others it should be possible to upgrade their working conditions.* We also appreciate, however, trade union concerns with "economic inefficiencies and socially unacceptable conditions" as a result of the core-periphery distinction[2]. Such consequences ensue if peripheral work becomes the permanent and involuntary fate of people and no provisions of adequate welfare or education and training are available to them. Clearly, the key is the extent to which it is possible to match the employment aspirations of individuals and the needs of enterprises. Furthermore, pressure for greater security is directly related to macro-economic conditions. As we noted before, labour markets function better as the level of economic activity increases.

**Work Practices and Work Patterns**

26. Work practices and work patterns provide significant opportunities for action. *Among the many relevant factors, which could be subsumed under this heading, we have noted the need to modify the organisation of work, notably when technological change is introduced, so as to enrich work content and raise levels of skill. We confidently expect that such action would lead to both productivity gains and greater mobility on the part of workers.* A further theme we have singled out is arrangements of working time. This decision may show a certain European bias; it certainly responds to topical debates in several European countries. However, the subject is of interest in most OECD countries. *Changes in working time not only promise trade-offs between individual wishes and economic needs, but also go to the core of attitudes to flexibility. The secular reduction in lifetime hours of work has been accompanied, almost everywhere, by remarkably rigid arrangements for entry into the labour market, weekly working hours, holidays, and retirement rules. These arrangements prevent enteprises from using their capacity fully, especially in view of technological changes; they make seasonal and conjunctural adjustments more difficult; they can lead to underemployment in some parts and deter additional employment in others; they do not reflect the wishes of many individuals. Changes to meet one or more of these deficiencies are therefore highly desirable.*

27. There are signs that the long-term trend towards a reduction of lifetime working hours has come to a halt. Initial training periods are no longer expanding; a conflict between demographic trends and retirement rules is emerging in a number of countries; actual hours worked are often stable, sometimes increasing. Overtime work continues to be an important source of additional income, and of seasonal or conjunctural flexibility in many countries. We doubt the desirability of these developments at a time of persistent unemployment. *A further reduction of working time, including overtime curtailments and early retirement arrangements, seems indicated in the short term. In the medium term, reductions of total hours worked may well have to be added.*

28. However, to prevent unit labour cost from rising, this reduction in total hours should be coupled with re-arrangements of working time. We have been much impressed by attempts to determine working hours for longer periods, such as a year, in order to reduce them overall, but at the same time encourage local arrangements for the flexible distribution of remaining hours[3]. Such arrangements are likely to lead to adjustments of prevailing rules concerning shiftwork, holidays, daily working hours, etc. However, at the local or enterprise level, they can lead to acceptable combinations of better capacity utilisation and greater control by individuals over their time.

29. For limited, but important groups of people, technological changes make the replacement of regular work in organisations by new forms of work contract possible. People can work at home for major portions of the week, using computers or other equipment, and deliver their services at times convenient to them and to their clients or firms. There are practical as well as social reasons why such arrangements cannot be generalised. At the same time, they too provide opportunities for combining individual and economic needs.

30. New work practices have numerous consequences. They are not all regarded as desirable by everybody. Insofar as they lead to variations, and often extensions, of the hours of operation of enterprises, some feel at a disadvantage; the reaction of family enterprises to flexible opening hours for shops is an example. Insofar as new work practices mean that people have time off at widely varying times, there are ramifications for family arrangements, school hours and holidays, leisure time activities. Such problems have to be taken into account when new practices are introduced. However, they are likely to lose importance as flexibility becomes the rule rather than the exception. *Work practices offer much scope for the convergence of managers' and workers' interests and thus for extending the principles underpinning this Report.*

**Rules and Regulations**

31. In the course of our deliberations, we were made aware of a number of rules and regulations which, while not directly related to employment, nevertheless have an effect on the labour market and its flexibility. Like non-tariff barriers in trade, they tend to proliferate, and often take the place of more traditional obstacles to free movement. We have singled out three because we believe that they are important. Except for the third, concerning small businesses, scope for action in this regard is probably limited.

32. There are first of all numerous and variegated rules which add to the fixed cost of enterprises and thereby compete with the cost of labour. In some cases, such as health and safety regulations, they are in fact indirectly related to employment; in others, such as environmental regulations, the relationship is more tenuous. *We are not suggesting that such*

*rules and regulations should be abolished but they should be applied in a reasonable manner. We also believe that their direct and indirect effects should be reassessed at regular intervals in the light of more advanced knowledge and technology.*

33. Peculiar problems affecting the labour market arise from levels and systems of taxation. Taxes of all kinds are important. We have discussed "payroll taxes" in the narrow sense under the heading of non-wage labour costs. However, taxes on goods as well as on incomes have an impact on employment, its level and composition. If marginal taxes rise above a certain point, there is little encouragement to move, or even to work at all. High levels of taxation have a direct impact on wage expectations. Steep progression of income tax at middle levels means special disincentives for skilled labour. If general tax levels are too high, the probability of what the Secretariat calls "concealed employment" rises in parallel. The emergence of such secondary labour markets not only has serious moral implications, but does not add to overall flexibility. It is unlikely to draw many new people into the labour market, and does not help change conditions of "visible employment". Systems and levels of taxation are at present a subject of public debate and government concern in a number of OECD countries. *The desire to avoid labour market distortions and rigidities must surely be one argument in favour of tax levels which help prevent tax evasion and tax avoidance, and tax systems which reflect perceived needs of differentiation.*

34. It is appropriate to single out at this point one special case, that is rules and regulations relating to the setting-up and running of small businesses. Small and medium-sized firms have an important place in processes of structural change. They are often sources of innovation, especially in view of the decentralisation permitted by recent technological developments. They also provide employment. Between one-half and two-thirds of all employees in OECD countries work in firms with fewer than 500 employees. Moreover, the Secretariat confirms that in some OECD countries there has been a trend in recent years towards a growing employment share in small enterprises and small establishments[4]. This can be explained in part, but not entirely, by the growing role of service enterprises. It is evident in the light of such developments that rigidities which prevent the setting-up or continuation of small and medium-sized businesses have serious effects for the labour market. Non-wage labour costs and employment protection rules figure among these rigidities; but in certain countries there are also administrative barriers to initiative. The concentration of government agencies in one place ("one stop shops") would be useful. *We have little doubt that a climate which is favourable for new ventures has contributed to some of the desirable trends on the United States labour market, and we recommend a review of the obstacles encountered by those who set up or run small businesses.*

**Mobility**

35. For many, the first issue that comes to mind when they refer to labour market flexibility is mobility. Indeed, for some, mobility and flexibility are almost synonyms. It is therefore particularly important to get one's concepts and facts right. When individuals willingly change their workplace, they are mobile. Among possible kinds of such moves, one distinction is of paramount importance, that between external and internal mobility. External mobility involves a change of employer or enterprise; internal mobility takes place within one enterprise or with one employer. External mobility may or may not involve geographical moves. Both external and internal mobility may be changes of workplace with or without (significant) changes of occupation, that is occupational or job mobility. For practical purposes,

geographical mobility, other external mobility, and internal mobility are the most important categories.

36. Differences between kinds of mobility are so great that few general statements about the subject make much sense. However, certain points are worth making. All forms of mobility contribute to labour market flexibility. The contribution is not easily measured. Very low mobility may make for undesirable rigidity, but from a certain point onwards, the economic, social and human cost of mobility becomes too high. The apparent decline in (geographical and job) mobility since the early 1970s noted by the Secretariat seems to indicate increasing rigidities; it therefore takes us back to the need for macro-economic policies to stimulate growth. The balance of stability and mobility may well differ from country to country. Moreover, it is important to remember that there is no simple relationship between mobility rates and the allocative efficiency of the labour market. As the Secretariat puts it: "To the extent that job mobility is associated with economic performance it is, by implication, uncertain whether Europe needs more of it (like the United States) or less of it (like Japan)".

37. In one respect, differences between countries may warrant a systematic conclusion. It may well be that kinds of mobility can be substituted for each other. In particular, it is not unlikely that internal mobility can take the place of external mobility and vice versa. For example, high internal and low external mobility in Japan contrasts with high external and low internal mobility in the United States; yet the labour market effect of both combinations may be similar.

38. One other general point is in place. Mobility differs from other factors listed here as issues raised by labour market flexibility in that, in free societies, it is not a condition which is brought about by direction. Whether people move or not is their own free choice. Mobility depends on other factors, such as macro-economic pulls and pushes, employment opportunities, income differentials and their incentive or deterrent effect, side-effects of social policy, housing policy, etc. In that sense, mobility is indeed almost synonymous with flexibility.

39. Kinds of mobility are much studied and allow clear conclusions. Geographical mobility is a highly effective, but also a costly aspect of the fluidity of labour markets. The cost is highest, and most evident, in the case of international migration. We note that in recent years such migration has declined significantly in Europe, though not in the United States. Perhaps the difference in cost between migration and long-range geographical mobility within countries is only gradual. *However, the combination of growing immobility and increasing regional differentiation suggests the need for action. There are several institutional factors which limit the volume of mobility between regional labour markets to some extent and we recommend action to remove them. Urgent action is needed with respect to the transferability of pensions, the opening-up of housing markets, and the abolition of counter-productive subsidies, as well as with respect to educating and training young people for moving within countries and across frontiers.*

40. External mobility which is not geographical presents fewer problems, although it too has its cost. High labour turnover may signify opportunities for individuals, but it also involves cost for firms, apart from being an index of morale problems. *External mobility is particularly important if it is occupational. Given the needs of structural adjustment and technological change, incentives for occupational mobility have to be strengthened. They range from income differentials to training opportunities. Even if the quantifiable effect of such measures on the*

*aggregate performance of the economy is limited, they should be seen as one of several parts of a comprehensive policy for structural adjustment and non-inflationary growth.*

41. Internal mobility is also described as functional flexibility. The extent to which it is even possible is evidently in part dependent on industrial structure; however, there are enough large enterprises in all countries to make internal mobility important. We wish to underline its importance because it epitomised our concern with identifying ways of combining security and flexibility: functional flexibility presupposes basic job security, but requires employees to be prepared to change job and occupation if necessary. In many countries, notably in Europe, obstacles to internal mobility are no less serious than those to external mobility. *Rules governing functional changes, the absence of effective arrangements for re-training, and attitudes which are characterised by a fear of change combine to bring about internal rigidities which prevent both technological and structural adjustments. The problem is above all European; in Japan, functional flexibility in large firms is pronounced, and in the United States, to the extent that it is absent it is compensated by external mobility. In Europe, this may well be one of the two or three major issues.*

**Education and Training**

42. The crucial importance of education and training is the least contentious issue in connection with labour market flexibility. *Both general education and vocational training need review. We share the view that education and training are keys to a more flexible workforce. They directly affect people's attitudes and contribute to occupational mobility as well as to the ability to come to terms with new work practices and other issues discussed in this Report. We observe, however, that the rigidities of the educational system and the constraints of public finance are, if anything, greater obstacles to change than the rigidities of labour markets.*

43. *We therefore recommend new initiatives in the field of education and training at a number of points. The most important among them are: Initial schooling has to provide people with basic knowledge and skills; it also has to prepare them for a vocational world of rapidly changing requirements; it therefore has to be broad education rather than narrow training. There have to be opportunities for training the growing category of those who work at the frontier of technological change. A large number of people need the time and the facilities for re-training during their working lives, if they do not want to run the risk to be defined out of the labour market. Such re-training must in part be geared to enabling people to keep up with changing requirements of their occupation, in part to making changes of occupation easier. There is a growing need for education for leisure, that is for opportunities to learn what to do with one's spare time both during and after working life. In sum, one is talking about lifelong learning for a flexible society.*

44. There are some signs of changes in the right direction. In a number of countries, industry has taken on training functions in order to make sure that skilled people can be found for changing jobs. Vocational training has become a subject of public debate in many places. Here and there, there are initiatives to promote training for leisure. Sporadically, the appearance of a new illiteracy and its human and social cost is discussed. But in the field of education and training generally, needs are still much greater than achievements. *Not only is it necessary to create new opportunities for education and training by public or private action, but many people have to be made aware of the consequences of insufficient or once-for-all training. Thus there is much scope for action by all concerned.*

## FLEXIBILITY AND STRUCTURAL CHANGE

45. These then are in our view the key issues which arise if one considers the uses and limits of labour market flexibility. We have described them as being more or less important. This begs the question: important for what? At this stage, it seems useful to relate the list of issues to the four objectives spelt out at the beginning of this Report: economic adjustment, technological innovation, unemployment and social problems, and quality of life. It is worth emphasizing yet again that labour market flexibility is but one, and probably not the most important factor affecting progress in these respects. In the first instance, macro-economic policies promoting non-inflationary growth are needed. For them to be successful, a set of structural measures has to be added. Labour market flexibility has its place in this structural set.

46. However, the strategic importance of labour market flexibility lies not only in the attitudes which it reflects and promotes, but in the fact that it has consequences for all four objectives. Some aspects of flexibility affect them all. Education and training, for example, are necessary conditions for adjustment, innovation, more employment and a better quality of life. Imbalances and rigidities of the tax system have wide ramifications. Mobility is relevant to several objectives. Probably, wage moderation is significant in all four respects, if only because it is a concomitant of the macro-economic policies which are required. However, such general effects apart, it is possible to identify packages of issues which are of special significance for each of the four objectives. Such packages indicate which rigidities of the labour market would have to be removed above all if one wants to attain a particular objective. They are thus a practical summary of the core of this Report (the following Overview presents the summary).

47. There is first of all the objective of labour market responsiveness to the needs of macro-*economic adjustment*. This is aimed at creating viable and competitive economic structures in the OECD countries. Under present conditions, this aim means change to sustain economic recovery and high growth. Increases in productivity, sectoral rearrangements and regional relocations have to take place. In other words, traditional industries will undergo transformations; new industries, both in manufacturing and in services, will emerge; new or revived industrial regions will take the place of old ones. In terms of the labour market, economic adjustment requires the most painful changes. A combination of wage moderation, reasonable rules of employment protection, the availability of new contracts, and the incentive effect of sectoral and regional wage differentials is important. There are, to be sure, other factors. For industry, and the economy generally, to become more competitive, the macro-economic climate is of major importance in inducing labour market flexibility. Inflexibilities in that market have been created by the failure of the macro-economic policies of recent years. Imaginative and forward-looking management attitudes are another factor. However, the adjustment package will inevitably touch the core of wages and conditions of work.

48. Economic adjustment and *technological innovation* are closely related; in some ways, each advances the other. However, it is useful to separate the two for purposes of discussion, if not of application. Certain features of the labour market are particularly relevant for technical change. These include above all occupational mobility, or in the terms used before, external mobility insofar as it is occupational, and internal mobility, as well as education and training. One subsidiary factor in this connection may well be the maintenance of appropriate skill

**Labour Market Flexibility and Socio-Economic Objectives: An Overview**[1]

| | Economic adjustment | Technological innovation | Unemployment | Quality of life |
|---|---|---|---|---|
| ***Labour cost*** | | | | |
| 1. Wage levels | x | | x | |
| 2. Regional differentials | x | | x | |
| 3. Sectoral differentials | x | | x | |
| 4. Skill differentials | | x | | |
| 5. Age differentials | | | x | |
| 6. Non-wage labour costs | x | | x | |
| ***Conditions of employment*** | | | | |
| 7. Employment protection | x | | | |
| 8. Part-time contracts | x | | x | x |
| 9. Fixed-term contracts | x | | x | x |
| ***Work practices*** | | | | |
| 10. Reduction of hours | | | | x |
| 11. Rearrangement of hours | | | x | x |
| 12. New forms of work | | | x | x |
| ***Rules and regulations*** | | | | |
| 13. Health, safety, etc. | | | | x |
| 14. Taxation | x | | x | |
| 15. Small business | | | x | |
| ***Mobility*** | | | | |
| 16. Geographical mobility | | | x | |
| 17. Other external mobility | | x | x | |
| 18. Internal mobility | | x | | |
| ***Education and training*** | | | | |
| 19. Education and training | | x | x | x |

1. Apart from providing a convenient overview this schematic presentation indicates, by an 'x', the relevance of each flexibility issue for the four objectives.

differentials. Again, many other factors contribute to attaining the objective. *Technological innovation is a pervasive process of change with institutional, financial and attitudinal preconditions of many kinds. But whereas the labour market requirements of economic adjustments may call for relocation and restructuring, the gist of technological change is transformation. It is not displacing people so much as changing what is required of them. This is why it requires adaptability within given employment settings – whether large enterprises or secure contracts – rather than mobility between such settings.*

49. One advantage of assembling factors in packages is that the importance, and the limits, of the contribution of labour market flexibility to the solution of the problem of *unemployment* become clearer. In theory, a totally flexible labour market leads to full employment; but as we have seen, not even theorists advance this as a practical proposition. In fact, the fight against unemployment is part and parcel of the medium-term scenario in which this discussion of labour market flexibility has its place. There is a need for macro-economic policies designed to

bring about non-inflationary growth; in addition, there are certain structural requirements. Among them, both economic adjustment and technological innovation are important. They produce stable jobs with a future, and the evidence suggests that at least as many new jobs are created as old ones disappear. Thus the factors which help adjustment and innovation are relevant for unemployment. Without wage moderation and balanced job security, fewer jobs will be created.

50. Thus there are important effects of labour market flexibility on unemployment. They include most aspects of labour costs and mobility. More particularly they include certain kinds of new contracts and part-time work. They also include work practices which improve the operation of enterprises and attract people who would otherwise remain outside the labour market. The employment effect of small businesses, and thus of the ease or difficulty of setting them up and keeping them going, has been mentioned earlier. All forms of mobility are from one point of view instruments for making sure that people are not defined out, by enhancing opportunities for employment. However, none of these factors has a major effect on the reduction of unemployment and the creation of new employment.

51. Youth unemployment is a matter of special concern in many OECD countries. It is particularly serious at times of high general unemployment. The subject has been studied in some depth by the OECD Secretariat, and it is as a result of such studies that the Secretariat concludes that it is important to secure a better match between the productivity of young workers and their labour costs. *This involves, in terms of the factors of flexibility, the maintenance of appropriate wage differentials for young workers, coupled with training schemes geared to the young. Where these are not adopted, a large number of young people may find themselves unemployed for long periods, or locked into unattractive low-paid jobs.*

52. It is a sad but unmistakable fact that while labour market flexibility has a certain effect on employment and unemployment, most of the measures discussed in this Report stop short of offering a solution for major social problems of the day. While not universal, these are sufficiently widespread to deserve mention. Inner-city decay, the downward spiral of decline in certain regions, and the emergence of an underclass are all related to unemployment. Those involved are frequently unemployed, and the phenomenon itself has grown in importance as unemployment has increased since the 1970s. At the same time, measures to promote labour market flexibility are not likely to reach the people affected by such problems. These measures tend to benefit people who are, however tenuously, a part of the labour market, but bypass those who remain outside it. We are not content with implicit or explicit notions of unavoidable unemployment of seven per cent or more, which is one reason why we have concerned ourselves at all with those who are untrained, unemployed except for transient periods in unstable and unattractive jobs, and apparently unable to get a foot in the door. Without a flexible labour market, it may be difficult to solve their problems; but such solutions require a special package the contents of which exceed our remit.

53. Improvements in the *quality of life and work* have long been a concern of working people and those who represent them. In recent years, the concern has risen, though it may have cultural as well as conjunctural aspects. The term, quality of life (and of work), refers to non-financial conditions of work and of life, and notably to the capacity of individuals to match their own wishes and aspirations with the organisation of work. This is largely, though not entirely, a matter of people's control over time. Who decides what one does, when and how? If only for this reason, work practices, including the reduction of working time and its more flexible rearrangement, are so important. However, new types of labour contract and

new forms of work are also relevant. The trade-off between security and flexibility, which has been a recurrent theme of this Report, is also significant in this connection, although it defies quantification.

54. Combining aspects of labour market flexibility in packages is not just a useful way of summarising the argument of this Report. It also helps understand observed differences between countries and serves as a useful guide to action. So far as countries are concerned, every one applies, of course, combinations of the packages distinguished here. However, it is striking that in some, like the United States, the economic adjustment package is particularly pronounced, whereas in others, like Japan, this is true for the technological package. Many European countries seem to show a preference for the quality of life package. There is no implication here that such preferences have to be expressed at the expense of other objectives. Indeed, as we have seen in the case of mobility, forms of flexibility may to some extent be substituted for each other. In any case, it is not the task of the High-Level Group to advise countries on preferences; we have been asked to "report on relevant policy options". But it is conceivable that analysis in terms of the flexibility packages discussed in this section would help identify the points at which particular countries might begin to improve the operation of labour markets. There may be a case for the OECD to assist this process by extending analysis of this subject in its annual economic surveys of Member countries.

## METHODS OF IMPLEMENTING CHANGE

55. The question remains: who is to take action in order to bring about an appropriate level of labour market flexibility? Our remit invites us to report on relevant policy options "in the field of government policies and collective bargaining". In fact, the possible agents of change in this area are many: governments, central, state and local; trade unions and employers' associations; intermediate agencies, public and voluntary employers and local leaders; public opinion. Moreover, there are major differences between countries with respect to the relative importance of one or the other of these agents of change. Nowhere are institutional, cultural and political traditions more pronounced than in this regard. What few general statements we have to make must therefore be taken with a great many reservations.

56. There is first of all a statement of fact. In many, though not all, OECD countries, recent years have seen certain changes in the relative role of agents of change. Governments have continued to play a major part not only in areas in which they are constitutionally responsible, such as legislation on health and safety, or public education, but also in industrial relations more generally. However, it appears that the scope for further action by governments in matters relevant to labour market flexibility is limited. Trade union membership in many countries is stagnant or declining. A lower degree of unionisation is often coupled with concentration on the defence of past achievements rather than demands for advancements. There are fewer strikes almost everywhere. At the same time, many decisions have come to be taken at the level of the individual enterprise, sometimes by unilateral action, usually by consultation and negotiation. It is difficult to tell how stable such trends are, or how universal they are going to be.

57. One reason why such facts are relevant is that they raise the issue of the relative merits of centralised and decentralised processes of decision-making. It is sometimes argued that centralised bargaining, or central decision-making, is bound to introduce rigidities into the process, whereas decentralised arrangements are more likely to reflect the real wishes of employees and the real interests of employers. Others hold against this the fact that, as long as comparability is a major factor in bargaining, decentralisation may have perverse economic effects. Moreover, centralised bargaining and national decisions can take into account overriding goals even if they contradict local interests. We see no reason to decide between these views in abstract, especially since there are major differences between countries. It appears that in practice certain adjustments are favoured by lower levels of bargaining. However, the evidence does not warrant any unambiguous conclusion in this respect.

58. The part played by different agents of change varies not only from country to country, but also from package to package, and perhaps from issue to issue. Taxation is not a subject of collective bargaining, and detailed work arrangements are not a subject of legislation. Given the importance of labour costs and conditions of employment for labour market flexibility, a special comment may however be in place about methods of wage-fixing. We note that the practice of automatic indexation has been halted or modified in almost all countries where it has been customary. Other more or less automatic mechanisms of wage-fixing have been debated, but not introduced anywhere. We take this to mean that the determination of wages (and of conditions of employment) remains a task for human decisions and defies once-for-all solutions. *Free societies have evolved a variety of methods to reach such decisions. Most rely largely on collective bargaining. A few put greater emphasis on lawful processes of conciliation and arbitration. But all recognise the importance of autonomous organisations of workers and employers. We believe, therefore, that strong unions and strong employers' representations are one condition of reaching decisions which are in the interest of all.*

59. In the past, many of those involved in industrial relations have favoured tripartite arrangements between governments, unions and employers. Given the fact that government is itself a major employer in most OECD countries, this is not surprising. Moreover, tripartite agreements may well have their uses in general economic policy. From time to time, public agencies can act as "honest brokers" in industrial conflict. *However, so far as labour market flexibility is concerned, we are agreed that meetings between government, unions and employers can play a useful role in order to exchange information and identify problems.*

60. Our main concern is a different one. Labour market flexibility raises sensitive issues. These touch not only people's sense of security, even of identity, but also the very survival of enterprises and the livelihood of those who work in them. *At least on the face of it, conflict between individual interests and economic needs is an inevitable concomitant of any attempts to increase labour market flexibility. This means in the first instance that precedence should be given to aspects of flexibility which promise a balance of advantage. There are such aspects, and we have indicated them in this Report. It means further that there is a great and continuing need for consultation and negotiation between those who propose to introduce change and those who are affected by it. Labour market flexibility must not become a weapon used by one group against another. If that happens, strife will ensue and progress will not take place. What is needed is a "social compact" by all concerned to seek ways which advance both economic efficiency and social progress.*



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## CONCLUDING REMARKS

61. Labour market flexibility has its place within the set of structural changes which are a condition of attaining the medium-term objectives of economic and social policy in OECD countries. While we have emphasized the crucial importance of following a policy of wage moderation in providing the basis for sustainable growth, we have also suggested that greater relative wage flexibility is less likely to be effective in promoting labour mobility and better economic performance than such factors as the existence of adequate job opportunities, the provision of appropriate educational and training facilities, and the minimisation of the costs of movement, including, for example, transferable pension schemes and suitable housing arrangements. We have further noted that internal flexibility can be an effective substitute for external flexibility. Consideration of differences between countries has led us to conclude that there is no standard set of measures which will serve all countries equally well. Each country will need to establish its own viable balance of measures and degree of flexibility as well as its particular method of implementing change, to fit in with its cultural and institutional environment. We have also emphasized that labour market flexibility is not the only nor the most important element in achieving economic and social progress. Such progress rests heavily on appropriate macro-economic measures designed to maintain a high level of economic activity. We have pointed out that labour markets function better as the level of economic activity increases. Moreover, the conflict between the desire for security and the need for change is likely to be more readily resolved in the context of a growing economy. Accordingly, the case for greater labour market flexibility which we advocate is more likely to succeed if measures are taken on an international scale to overcome the current sluggish demand growth and high real interest rates.

62. In this setting, there are at least three reasons why the flexibility of labour markets has a strategic role to play in the search for economic efficiency and social progress. One is that it provides a link between specific economic and wider social issues. We have emphasized throughout that labour market flexibility is but an aspect of a wider social flexibility which is needed. There are attitudes involved here which have much to do with the dynamism of economies and societies. In this Report, we have not explicitly discussed what might be called management flexibility. However, it should be clear that to draw the maximum advantage from labour market flexibility it is necessary for employers and managers to show a sense of adventure and imaginative change as well as responsibility. Another strategic aspect of flexibility has accompanied this Report throughout. Security of employment is needed as well as innovation. They are both individual aspirations and collective requirements. Like economies, and societies more generally, individuals want to have reliable perspectives of life but avoid stagnation. The issues of labour market flexibility suggest a balance between security and innovation, or rather, several possible balances. There is a third strategic implication of labour market flexibility. Economic policy, like policy generally, has to respond to immediate problems and seek solutions in the short term. However, some of the problems of contemporary economies are not short-term. This may be another way of describing the combination of macro-economic policies and structural changes which is needed. In any case, there are medium-term issues of policy. And again, labour market flexibility provides a link. *There are measures which can be introduced soon, though their effect is likely to take some time. We have little doubt that all countries have a long way to go in this respect. The steps to be taken differ, but the need is general. Dynamic economies bent on sustainable growth will have to be flexible. Labour market flexibility is one of the conditions for their success.*

## NOTES AND REFERENCES

1. Address by Mr. Jean-Claude Paye, Secretary-General of the OECD, to the Parliamentary Assembly of the Council of Europe, 1st October 1985.
2. Quoted from the introduction to the paper by the British TUC: *Flexibility: A Trade Union Response*. TUC, London, December 1985.
3. We have had the opportunity to become acquainted with the French project of legislation which suggests a quid pro quo of this kind.
4. For a detailed analysis from which this is quoted, see *OECD Employment Outlook*, Paris, September 1985, especially Chapter IV.

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